CEPS COMMENTARY
Thinking ahead for Europe

The Brexit Negotiations: An Italian Perspective

Stefano Micossi and Riccardo Perissich

25 October 2016

At the moment, the only certainty in the forthcoming Brexit negotiations is...uncertainty. The British prime minister has announced that formal notification to leave the Union will be given by March 2017, but the precise nature of the UK's opening position is likely to remain unknown for months to come. Nor do we know when negotiations will start, since after receiving notification the European Council will have to agree on a mandate for its negotiators. All we can do at this stage, therefore, is set out our hypotheses on the likely shape of the British negotiating position and discuss, in this context, what Italy's interests and reactions might be.

The economic impact of Brexit

A cursory look at the trade statistics shows that the static impact of Brexit cannot be very big (Table 1). The UK is a net importer of goods from the EU (with which it has a large deficit of about 4.8% of GDP) and a net exporter of services to the EU (with a surplus of around 1% of GDP). At least initially, restrictions on access to the Single Market might worsen both, but the exchange rate depreciation might offset this to some extent. However, as noted by Gros (2016), for a number of years now the UK's trade flows have increasingly been diverted to the rest of the world. This is especially the case for services, where the country has developed a very large surplus.

Table 1. UK trade with the EU and the world, 2015

	Total trade			Trade in goods			Trade in services		
	Exports	**Imports**	**Balance**	**Exports**	**Imports**	**Balance**	**Exports**	**Imports**	**Balance**
World									
£ million	508,767	547,441	-38,674	283,282	409,719	-126,437	225,485	137,722	87,763
% of GDP	*27.2*	*29.3*	*-2.1*	*15.2*	*21.9*	*-6.8*	*12.1*	*7.4*	*4.7*
EU									
£ million	222,433	290,969	-68,536	133,524	222,992	-89,468	88,909	67,977	20,932
% of GDP	*11.9*	*15.6*	*-3.7*	*7.1*	*11.9*	*-4.8*	*4.8*	*3.6*	*1.1*

Source: Office for National Statistics.

Stefano Micossi is Director General of ASSONIME, Chair of the LUISS School of European Political Economy, and a CEPS board member. Riccardo Perissich is Riccardo Perissich is a former Commission official and Executive Vice Chairman of the Council for the United States and Italy.

An earlier version of this paper appears as a chapter in a VOX e-book entitled: *What To Do With the UK? EU Perspectives on Brexit* edited by Charles Wyplosz, and is published here with the kind permission of VOX.

In Table 2, we show the trading and financial relationships of the four largest EU countries with the UK. Again, the numbers are small. Germany stands out for relatively large merchandise (export) flows, and France for large portfolio investments, but altogether it is difficult to detect any seismic activity here for the time being. The numbers for Italy are tiny on all three dimensions (trade, portfolio investment and direct investment).

Table 2. Trading and financial relationships between the UK and main EU countries (% of **GDP)**

	Trade (goods and services, 2014)		**Portfolio investment** (stocks, end of 2015-Q2)		**Direct investment** (stocks, end of 2014)	
	Exports	Imports	Assets	Liabilities	Assets	Liabilities
Italy	**1.7**	**1.1**	**3.9**	**6.8**	**1.3**	**2.2**
France	2.5	1.9	11.1	12.7	4.9	2.2
Germany	3.4	2.1	6.5	8.8	2.8	0.7
Spain	2.9	1.8	3.2	7.2	6.0	1.7

Source: Banca d'Italia Economic Bulletin No. 3, July 2016.

The long-term effects might be more substantial to the extent that Brexit elicits new patterns of direct investment – for example, if Japanese car manufacturers move their plants to another EU location (possibly in Eastern Europe), or financial traders (clearing in euros) abandon the City for Frankfurt, Amsterdam or Paris (see Lannoo, 2016). Some of this investment might well also be attracted to Milan, whose *Borsa Italiana* is owned by the London Stock Exchange Group. Yet while public and private actors in the EU are positioning themselves to take advantage of Brexit, any conclusion on the eventual effects would be highly speculative at this stage.

Timing

The reason the UK government has not yet formally given notice of its intention to exit from the EU is quite obvious: they first need an in-depth evaluation of possible approaches to Brexit, without which they simply cannot line up their opening shots in the negotiations. An important constraint here is that the government will not want the UK to participate in the next elections to the European Parliament, to be held in June 2019. On this, Article 50 of the Treaty on the European Union (henceforth, 'Article 50') provides that "the Treaties shall cease to apply to the state in question from the date of entry into force of the withdrawal agreement" (para. 3) or, if an agreement cannot be reached, two years after the notification of the intention to exit. Notification by May 2017 would normally ensure that Brexit happened before the next European parliamentary elections.

After receiving the notification, the European Council will have to agree – by qualified majority – on a mandate for the EU negotiating team, and then seek the consent of the European Parliament under the procedural rules for international agreements (Article 218 of the Treaty on the Functioning of the European Union). This may take some time, in view of the electoral cycles that will then be under way in France and Germany. While this may delay the negotiations, however, it will not alter the deadline set by Article 50. A strong incentive for both contracting parties to accelerate the negotiations will be provided by the desire to put an end to the current state of uncertainty, which is paralysing investment decisions on both sides of the Channel.

Italian attitudes towards the UK

Let us note at the outset that Italy has been a strong supporter of the UK's membership of the European Community since the early days. The motivation for this has been twofold. The first is a long tradition of friendship that, with the exception of the Second World War, goes back to the UK's support for the *Risorgimento*. The second is that Italy hoped that the UK could provide a welcome balance to the dominance of the Franco-German partnership. Despite several attempts on the Italian side, this strategy has always led to disappointment; Britain, despite some polite noises, never really took any notice.

The fact is that apart from being uneasy with the role of France and Germany, the UK and Italy have very few common interests – the most important of which is probably that both countries are strongly pro-US and are attached to NATO. One of the rare moments when the two nations were aligned against France and Germany was when Berlusconi decided to side with George W. Bush and Tony Blair and support the war in Iraq. Another area where the interests of both countries have often been aligned is trade, and the UK's diminished influence on the ratification of the EU-Canada Comprehensive Economic and Trade Agreement (CETA)[1] and the now-frozen TTIP negotiations will be sorely felt by Italy.

Despite all this, Italy was forthcoming during David Cameron's attempts to negotiate conditions for continued UK membership of the EU, so the vote in favour of Brexit has been met with regret and dismay.

It should also be noted that Italy has once again become a country of emigration. It is estimated that in recent years between 60,000 and 100,000 young Italians have moved abroad every year to seek employment opportunities, mainly to other parts of the EU. Moreover, about 600,000 Italians are working in the UK.

What negotiations?

There will be two parallel negotiations: one to extricate the UK from all relationships with EU institutions and policies, the other to define the new trading and investment relations between the UK and the EU (including new arrangements for the circulation of workers). The first negotiation – the 'exit' negotiation under Article 50 – does not involve difficult questions of principle. It mainly concerns the interruption of payments flowing between the EU's budget and the UK; the treatment of UK personnel by EU institutions (including pension claims); the splitting up of common properties of EU institutions (buildings and the like); and the relocation of the two EU agencies located in London (the European Banking Authority and the European Medicines Agency).

The crucial negotiation is of course the second one, which is akin to a comprehensive trade and investment agreement and is likely to take several years. On this, Article 50 only makes an oblique reference to the effect that exit negotiations will take account "of the framework" for future relationships between the exiting country and the EU, but the European Council has explicitly ruled out any dialogue in this domain as long as the intention to exit has not been formally notified.

EU legislation, as well as standing trade agreements negotiated between the EU and third countries, also on behalf of the UK since 1973 (numbering over 140), will cease to apply to the UK upon exit, but not before. One unpleasant implication is that, until exit takes full effect, not only must the UK continue to apply existing EU rules and treaties (under the control of the Commission and the European Court of Justice), but it cannot formally start separate trade and investment negotiations with third countries (since the power to negotiate trade agreements on behalf of its members belongs exclusively to the EU).

There is therefore hardly any room for the UK to try to divide EU members and seek separate settlements with some of them. There is one area, however, where Brexit can elicit fresh divisions between remaining member states, and that is the common budget. Assuming that "Brexit is Brexit", all UK payments to and from the EU budget will cease. Since the UK is currently in a sizeable net creditor position (by about €7 billion per year), a decision would have to be taken on how to allocate this net reduction in revenues. Table 3 shows how the net contributions of some creditor countries would be affected, under the assumption that spending levels are not modified (based on estimates by Nùñez Ferrer and Rinaldi, 2016). The extra burden would not be huge, but neither would it be negligible, especially for Germany and France. With the prevailing budgetary stringency in most countries, it is perhaps more likely that the missing UK contribution will lead to a reduction in spending, with vociferous complaints from recipients.

[1] CETA has already been agreed upon by negotiators, but its ratification has been called into question by the EU's decision to subject its entry into force to ratification by all member states. Thus, the proposal will have to be approved by 38 national and regional assemblies, as prescribed by national procedures for the ratification of international treaties. The Italian government has been a strong advocate of immediate ratification of the agreement.

Table 3. Total contributions and net balances to the EU budget for selected countries, 2014 (billion euros)

	Total contributions	**Net balance***	**□□contributions with UK out****
Austria	2,9	-1,3	0,5
France	21,0	-7,5	1,5
Germany	29,1	-17,7	2,6
Italy	15,9	-5,2	0,8
Netherlands	8,4	-6,4	-0,1
Sweden	4,3	-2,6	0,4
United Kingdom	**14,1**	**-7,1**	-
EU-28	133,0	-4,4	**7,1**

*computed as the difference between total EU expenditure in the member states and total contribution to the EU budget by member state, including adjustment for the UK rebate and for Justice and Home affairs.
Source: European Commission and ** Nùñez Ferrer and Rinaldi (2016).

The UK's likely position

Discussions will be shaped by the type of relationship that the UK will choose to have with the EU. Should Britain go for a 'hard Brexit', abandoning the Single Market altogether, negotiations will be relatively simple as we shall have to discuss how to disentangle existing links, discuss a trade pact, and maybe other issues that are not central to the functioning of EU institutions, such as cooperation on security.

If, on the other hand, the UK wants some form of participation in the Single Market (either tailor-made or following an existing model), two critical issues will be at the centre of the negotiation: the free movement of people, and the extent to which EU regulations will be applied by the UK. The latter question is as important, if not more so, than the former.

The cornerstone of the Single Market is the common set of rules that allow the free circulation of goods, capital, services and people. To retain full access to the EU market, The UK would have to agree to respect the rules decided by EU institutions and, equally important, the authority of the European Court of Justice. A return to full sovereignty for the UK parliament was one of the main motivations for the vote to leave the EU; and indeed Prime Minster May has now indicated that she wants the UK to become a "fully independent sovereign country" – a clear sign that she will aim for a clean break from the Single Market.

Of course, the UK may choose to negotiate full access for some sectors (for instance, financial services), but the problem of principle would remain. International trade negotiations also provide for mechanisms to recognise, on a case-by-case basis, the 'equivalence' of national rules. This could be helpful in some cases, and it has been suggested that it could be a second-best alternative if agreement on the 'passport' for financial services proves impossible. Experience of discussions with the US regarding the TTIP, however, suggests that, in practice, negotiations would not centre on the convergence of the regulations, but rather the transparency and – as far as possible – the convergence of the regulatory processes. As far as the EU is concerned, its institutions would remain the sole judges of the degree of equivalence, posing a possibly insurmountable political problem to the UK electorate once again.

Resistance from the EU side to weakening the integrity of the decision-making process is likely to be even stronger than in the case of the free movement of people. Italy is sure to take a strong stand against any concession on this question.

On the free movement of labour

On the issue of free movement of labour, Pisani-Ferry et al. (2016) have argued that this problem belongs to the 'political' dimension of the EU and is not an integral part of the Single Market. As a consequence, in the framework of a negotiation exclusively focused on the economic relationship with a non-member, the EU may well consider granting concessions that were refused to David Cameron last year. It has also been suggested that, given the tensions in many countries over the issue of migration, Brexit could provide an opportunity to change existing EU policies. We believe this approach to be utterly wrong, for a number of reasons.

The Schengen Area and the free circulation of EU citizens are easily confused, but they are not the same thing. The Schengen agreements – later incorporated into EU law by the Amsterdam Treaty in 1997 – abolished internal border controls between member states (with opt-outs by the UK and Ireland) and established a common external border to the EU, supplemented by common visa controls and police cooperation (also applied by Iceland, Norway and Switzerland). The Council now wants to strengthen this construction with a common border and coast guard.

Many ongoing discussions, and tensions, between the member states in the European Council are centred on the issue of the effective control of the common external border against migrants from third countries, terrorists, drug traffickers, and so on. The condition for saving Schengen from oblivion is re-establishing effective border controls vis-à-vis third countries. This was successfully carried out on the eastern border by closing the Balkan route to migrants, but it has yet to be achieved on the southern border. France and Austria are threatening to reintroduce border controls because they do not want to take migrants who land in Italy and whom Italy would like to see move north. In this respect, it can be said that while Schengen also has an economic dimension, it is a 'political' project, of which the UK has never been part.

The principle of the free movement of people, on the other hand, is an integral part of the Single Market and applies to all EU countries, irrespective of whether they are part of Schengen. It is not difficult to see that, without the free movement of people, the freedom of establishment and the freedom to provide services across borders are nullified. The City is well aware of this – and for this reason has advocated maintaining free circulation for qualified people after Brexit, without which their ability to operate on the continent would be crippled. But there is more – under Article 3 of the Treaty on the European Union, freedom, security and justice form a central part of EU citizenry, and the four freedoms appear as an inseparable political right.

By and large this right – the free movement of EU citizens – is not called into question in the EU, apart from in the UK, where over three million EU citizens are currently working and residing. In Italy, there are close to one million Romanian citizens, for instance, but there has been practically no negative reaction among the public, apart from in response to the very specific problem of the Roma community. We are all aware that there may be cases of abuse of social security or labour laws; however, the jurisprudence of the Court of Justice can take care of most of these problems and, if necessary, the rules can be adapted.

For these reasons, as well as in order to protect the interests of Italian citizens who wish to work or study in the UK, we fail to see why Italy should show flexibility in response British demands on this score. The free movement of EU citizens is one of the foundations of the Union; by weakening it, we would endanger the entire construction, and undermine the support of those who still want a stronger and more integrated Europe (and possibly political union) to emerge from the current convulsions. Concessions in this area would also further compromise the already tense relations with East European member states.

Conclusion

Looking at the forthcoming negotiations, Italy can therefore be expected to be helpful, but there will be strict limits to its flexibility. The main concern will be that uncertainty surrounding Brexit does not impinge on pressing intra-EU and intra-eurozone questions. Broadly speaking, Italy will attach high priority to preserving the integrity of the basic principles that govern the EU (including the institutional balance) and to the possibility of the eurozone integrating further.

References

Gros D. (2016), "The Not-So-High Costs of Brexit", Project Syndicate, 8 September.

Lannoo K. (2016), "EU Financial Market Access after Brexit", CEPS Policy Brief, September.

Núñez Ferrer J. and D. Rinaldi (2016), "The Impact of Brexit on the EU Budget: A non-catastrophic event", CEPS Policy Brief No. 347, September.

Pisani-Ferry J., N. Röttgen, A. Sapir, P. Tucker and G. B. Wolff (2016), "Europe after Brexit: A proposal for a continental partnership", Bruegel, 25 August.